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Implementation of and follow-up to major United Nations conferences and summits: Follow-up to the International Conference on Financing for Development

Summary by the President of the Economic and Social Council of the special high-level meeting of the Council with the Bretton Woods institutions and the World Trade Organization (New York, 26 April 2003)

Addendum 2

Summary of informal hearings of the business sector on financing for development (New York, 24 March 2004)***

Summary

In preparation for the special high-level meeting of the Economic and Social Council with the international financial and trade institutions, held on 26 April 2004, on the theme "Coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus", the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat had organized informal hearings and an interactive dialogue with business representatives accredited to the financing for development process. The event, chaired by the President of the Economic and Social Council, Marjatta Rasi (Finland), took place at

* A/59/50 and Corr.1.
** E/2004/100 and Corr.2.
*** The present summary was prepared by the staff of the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat, in consultation with the moderators and panellists of the meeting.

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United Nations Headquarters on 24 March 2004. The overall theme of the meeting was "Mobilizing private investment for development". The hearings and dialogue featured panel discussions on the following two topics: (i) Improving information for private investors in developing countries; and (ii) Mitigating risks facing private investors in developing countries. Each panel session consisted of introductory remarks by the moderator and presentations by business sector panellists followed by discussions with Council delegates, including questions from the audience. Salient substantive features of the proceedings of the meeting are summarized below.

Opening of the meeting

1. The Chairperson of the meeting, Ms. Marjatta Rasi (Finland), President of the Economic and Social Council, opened the meeting and welcomed all panellists and participants. In her opening remarks, she expressed satisfaction with the active engagement of the business sector in the follow-up to the International Conference on Financing for Development. Ambassador Rasi stated that the deep commitment of the business sector to moving forward the financing for development process was illustrated by the richness of the substantive ideas and suggestions put forward by business representatives. She outlined the organization of the meeting, introduced the moderators and the topics to be discussed by the panels, and encouraged an open and frank exchange of views.

2. Mr. Paul Underwood, Executive Director, Business Council for the United Nations, explained that the presentations at the hearings would draw upon the findings of an expert workshop on "Mobilizing private sector investment in developing countries", which had been held on 23 March 2004 at the Business Council for the United Nations. Mr. Underwood pointed out that the workshop had been a multi-stakeholder event, given the fact that senior experts from Governments, multilateral organizations and the private sector in developed and developing countries had been present. The workshop had addressed two themes: (i) improving information for private investors in developing countries; and (ii) mitigating risks facing private investors in developing countries. The diversity and number of participants in the workshop had been most encouraging and indicated the importance attached to those issues in both public and private sectors. The workshop had marked an important stepping stone and deserved proper follow-up. He urged delegates to the Economic and Social Council to communicate to their respective national authorities the outcome of the workshop and to promote the idea of working jointly with the group of business sector experts in the area of mobilizing private investment for development.

Panel 1
Improving information for private investors in developing countries

Presentations

3. The Moderator of the panel, Ms. Barbara Samuels, President, Samuels Associates, opened the session by summarizing the findings of the first part of the expert workshop, on the issue of strengthening information for investors in developing countries. She highlighted six critical areas for improvement: (i) the insufficient use of existing information by investors and policy makers; (ii) the lack of reliable, relevant information on country business environments (for example, sector specific information, cost factor analyses by region, information on enforceability of contracts, sources of local finance, regional economic opportunities/risks); (iii) the insufficient credibility of information; (iv) the need for neutral organizations or expert panels to provide independent and open expert assessments of information; (v) the need to increase the analytical capacity of investors and policy makers; and (vi) the need to improve methods used for risk assessment at both macro and project levels. Key recommendations of the expert

group covered the following two areas. First, there was a need to enhance mechanisms for private-public collaboration and partnership on the above issues through enhancing existing expert groups and creating new ones, through further developing tools to strengthen government-investor dialogue and through mechanisms to improve the quality and credibility of information. Second, efforts should be made to improve the quality and synergy of existing open web-based information portals as cost-effective vehicles to disseminate information through strengthening linkages with key information providers and using technology to its maximum potential.

4. Mr. Armstrong Takang, Chief Executive Officer, Alteq (ICT) Ltd. (Nigeria), spoke about industry best practices for providing information to investors. He described the challenges in gathering, processing and disseminating information in developing countries such as Nigeria. Mr. Takang pointed to the need for investment in capacity-building in information infrastructure, including training that would provide guidance on the gathering, analysis and dissemination of high-quality information. In that sense, best practices would include strengthening the provision of sector-based information, documenting and providing easy access to investment-related legislation and policies and making investment-related local laws and policies publicly available and measurable. In addition, the provision of portal-based information and on-line analytical capabilities was an important tool. Mr. Takang also strongly emphasized the limitations of the traditional information models employed by foreign investors in developing countries such as Nigeria. Those models typically failed to reflect the social, cultural and political peculiarities of a developing country and efforts must be made by investors to incorporate those factors in their decision-making. Thus, more research and development should be devoted to understanding the impact of social and cultural variables on investment, and traditional information indicators needed to be "indigenized". In addition, Mr. Takang stressed the need for both governmental and non-governmental providers of information to co-exist, thereby enabling investors to have a full and balanced view of developments in a given country.

5. Ms. Maggie Kigozi, Executive Director, Uganda Investment Authority, described efforts made to strengthen the provision of information for investors in Uganda. The Uganda Investment Authority maintained an interactive, frequently updated web site, providing crucial information for investors, such as information on geographical distribution of land. She emphasized the importance of having a dialogue between the public and private sectors, for example, through the United Nations Conference on Trade and Development/International Chamber of Commerce Investment Advisory Council, the Africa Business Round Table of the Organization for Economic Cooperation and Development, the SMART Partnership dialogue, the Africa-Asia Business Forum, the New Partnership for Africa's Development (NEPAD) and, specifically for Uganda, the Uganda Investor Round Table. Ms. Kigozi referred to the successes achieved in East Africa in attracting greater amounts of foreign direct investment, through reforms that strengthened the enabling environment for both foreign and domestic enterprises. She also emphasized the importance of developing Internet-based country investor networks that would facilitate direct and frequent communication between Governments and investors.

6. Ms. Jolanta Wysocka, Portfolio Strategist, Frank Russel Company (United States of America), stressed the importance of information in facilitating the

development of local capital markets in developing countries. Local capital markets were important in attracting and channelling both local and foreign investment. However, the functioning and development of those markets would be aided by having timely, credible and transparent information for investors. In addition to institutions such as rating agencies, initiatives like the Global Information Clearinghouse could also play an important role in providing investors with the necessary information. Ms. Wysocka urged Member States of the United Nations to support that initiative.

7. Mr. Nicolas Gadano, Senior Economist, Repsol YPF (Argentina), spoke about the 2001 financial crisis in his country and the importance in that context of strengthening the provision of information for investors. He considered that it had been more the lack of independent assessment of the country's macroeconomic situation, than the lack of transparency per se which had aggravated the country's economic problems. In particular, the International Monetary Fund (IMF) might have had conflicting roles in that it had been a large creditor at the same time as having the key task of assessing the macroeconomic stability of the country. As a result, Mr. Gadano suggested, IMF might continue to be constrained in its freedom and independence to highlight fully the macroeconomic risks faced by other countries. He recommended that an alternative international organization, not involved in lending to countries, should be handed the key surveillance responsibility for assessing and highlighting macroeconomic risks.

Discussion

8. The limitations of traditional information models brought out during Mr. Takang's presentation were reinforced during the discussion. In particular, a business representative pointed out the need to have information on various intangibles, which were nevertheless crucial for investors, such as who in a given country would have the right to sign contracts and in what field. Those factors assumed significant importance when disputes arose and terms and conditions in a contract were reneged upon. While the efficacy of the legal system in resolving disputes was critical, it would help investors to have information beforehand on political, legal and cultural dynamics that might determine the efficacy of their investment.

9. It was pointed out that in many instances it was helpful for global information to be compiled in a form that was sector-specific rather than country-specific. Investors tended to look for opportunities to invest in specific sectors rather than specific countries and compilation of facts and figures in a sectoral form would therefore enable them to detect a lucrative investment opportunity with greater ease. At the same time, such sectoral information would also draw attention to projects in countries that might not have been on the top of investors' lists.

10. A participant posed a question as to whether complete information transparency was desirable, given the assumption that it was often lack of transparency that enabled companies which had private information sources or were better skilled in interpreting information to maintain a competitive edge. The response from business representatives was that, while complete information transparency was never possible in a competitive capitalistic environment, there should be basic transparency about "the rules of the game". Yet, the real world was very far from satisfying that basic need, which would in fact facilitate efficient

competition among companies and, at the same time, would enable developing countries with sound fundamentals to better mobilize and attract capital.

11. The issue of language barriers impeding investment was raised. It was pointed out that foreign investors were more comfortable operating in countries where there were fewer language barriers and that host countries needed to provide multilingual sources of information.

Panel 2
Mitigating risks facing private investors in developing countries

Presentations

12. The Moderator of the panel, Mr. Dan Bond, First Vice-President, AMBAC Assurance Group (United States of America), opened the session by summarizing the findings of the second part of the expert workshop, on the issue of mitigating risks facing investors in developing countries. In most developing countries, there was a critical need to attract both domestic and foreign private capital to finance infrastructure projects (not least because of budgetary constraints faced by their Governments). However, there had been a sharp decline in private funding going into critical sectors such as water and power. In order to increase private financing of infrastructure projects in developing countries, fundamental reforms were needed to overcome the barriers to investment. Those barriers included non-transparent and unstable regulatory systems, macroeconomic instability, foreign exchange restrictions, weak legal and judicial systems, and failure by Governments to honour contractual commitments. At the same time, various financial structures had been developed or proposed to "mitigate" the political and sovereign risks faced by private investors. Those structures were, in turn, dependent on an explicit sharing of risks between the public and private sectors. Mr. Bond outlined a number of promising approaches to risk sharing, including project pooling, global development funds, liquidity facilities to overcome temporary shocks to project finances such as a massive devaluation, local currency guarantees, concessionary finance to subsidize targeted users, international arbitration to ensure government contracts and concession agreements, etc. In order for those techniques to find wider application, an increased dialogue between the public and private sectors was needed. Mr. Bond recalled that the Experts Group on Developing Country Infrastructure Finance (www.InfraDev.org) had been initiated at the Monterrey Conference in order to facilitate such dialogue. He invited experts from the private and public sectors to join that group and help develop further risk-sharing mechanisms.

13. Mr. John Salinger, President, AIG Global Trade and Political Risk Company (United States of America), argued that globalization had been severely undermined by losses incurred by investors, especially those in infrastructure projects in developing countries (even in large and relatively sophisticated ones). There was a lack of respect for legal agreements in developing countries and the expected rate of return on projects was not sufficient to compensate for the real risks involved. For that reason, developing countries would find it difficult to attract foreign private finance for infrastructure projects unless fundamental reforms were passed along the lines suggested by Mr. Bond. One particular point stressed by Mr. Salinger was the "denial of justice" experienced by foreign investors when local authorities had reneged on contracts. He felt the effective use of international arbitration and

dispute resolution procedures would be helpful in that respect. Mr. Salinger also emphasized the need to compare projects that failed with those that were successful and objectively assess and promote best practices.

14. Mr. Pradeep Singh, Chief Executive, Infrastructure Leasing and Finance Services (India), referred to a paradox where a shortfall of finance for infrastructure projects in developing countries co-existed with large amounts of capital searching for investment opportunities around the world. The reason for that paradox lay in the shortage of well-designed projects with investment potential in developing countries. Investor guarantees did not address that problem since they were exercises in risk allocation rather than in risk mitigation. Instead, there was a need to examine ways of improving project fundamentals as well as of reforming aspects of the policy and legislative environment that generated risks for investors. There was also a need to create project development capacities within Governments in developing countries that would provide for credible risk identification, risk mitigation and allocation structures for projects and for addressing the information requirements to minimize uncertainties in the perceptions of the private sector and the lending institutions. To that end, there could be established a permanent professional body in individual developing countries that would provide continuous and competent guidance to public-private partnerships and to the stakeholders in the public and private sectors. Multilateral organizations like the United Nations, and other donors, could assist in creating institutional arrangements and a regulatory environment that would facilitate the work of such a body (e.g., through establishing and updating guidelines for public-private partnerships, assisting in the creation of a legislative framework to guide political and bureaucratic decision-making related to public-private partnerships and supporting staff training to build up technical skills). Mr. Singh argued that the returns from such an effort would be significant, while the resources needed would be relatively small.

15. Mr. Jacques Labre, Senior Water Adviser, Suez Environment (France), spoke on the issue of improving the predictability of revenue for water and sanitation service providers in developing countries. While private investors required an adequate return, there was often a lack of connection between the tariffs set by public authorities and the costs incurred by operators — both public and private — owing to the social and political sensitivities of raising water tariffs. Hence, the average cost recovery ratio for water services had been estimated by the World Bank at only 40 per cent. Nevertheless, Mr. Labre argued, sustainable cost recovery would be achievable in most large cities over the medium term if there were a well-designed but socially equitable policy of progressive tariff adjustments accompanied by risk mitigation instruments. Looking back over the previous 10 years, he said that public-private partnerships in that area had worked in those instances where the contracts had been well designed, where there had been no exposure to foreign exchange risk and where the investment had been funded on the basis of cash flow from water revenues rather than on debt. Where problems occurred, that was often due to a refusal by public authorities to apply tariff adjustment clauses in the event of a macroeconomic shock or political instability, asymmetries in the protection of parties against breach of contract (i.e., the private sector was not adequately protected in comparison with the public sector) and water company revenues being affected by non-payment by public sector users. Mr. Labre proposed the establishment of a tariff risk mitigation instrument, whereby the public authority would guarantee the operator against unilateral decisions on tariffs, but would have

access to an appropriate counter-guarantee backed by a multilateral agency. The cost of such a counter-guarantee should be minimized through donors' support.

16. Flavio Diaz Miron, Director, Legal Affairs and Government Relations, Ford Motor Company (Mexico), while accepting the paramount importance of an enabling investment climate, argued that the intense competition for global capital would sometimes require countries to provide direct incentives to attract companies. Many developed countries provided valuable incentives, including cash grants, to attract investment (sometimes even in the face of World Trade Organization (WTO) restrictions). Many developing countries did not have the resources and adequate legal structure to grant such incentives and honour them through the life of the investment cycle. However, a number of developing countries were building up huge amounts of foreign reserves and could use them to provide incentives to attract investment. Such incentives should be used very selectively, however, and only for those projects in strategic sectors that would have significant direct and spill-over effects on the host economy.

Discussion

17. The Under-Secretary-General for Economic and Social Affairs, Mr. José Antonio Ocampo, while accepting the importance of guarantee schemes and incentives for capital flows, especially in the least developed countries, pointed out that the most severe difficulties occurred during times of crisis when Governments were least able to fulfil guarantees or implement other remedies since they did not have the resources to do so. Further discussions would be essential to identify appropriate ways and means to address that problem. Another important issue concerned the sharing of risks. While agreeing that projects should be unbundled and there should be a reasonable sharing of risks, Mr. Ocampo said that normal market risks should not be assumed by Governments. In particular, he emphasized that such risks as the exchange rate risk or the interest rate risk should be considered as normal market risks and should not therefore be covered by Governments but rather should fall under the responsibility of the private sector. Mr. Ocampo acknowledged the problems posed by the exchange rate risk for non-tradable services producers in developing countries who borrowed in foreign currency from abroad. However, he did not accept the point that Governments should compensate them for that risk and suggested that there should be better ways to deal with that problem, including greater financing in domestic currency.

18. A representative of the business sector said that the division of risks between the public and private sectors should be fairly balanced. Risks transferred to the operator would ultimately mean additional costs were passed to the final user through the tariff. Traditionally, infrastructure services like water were highly subsidized in developing countries. Phasing out subsidies and transferring at the same moment to a private operator risks that are beyond the operator's control (like foreign exchange or regulatory risks) would cause steep tariff increases that would not be socially acceptable. Keeping the cost of sovereign risks on the government side should be part of a policy of managing a smooth transition on tariffs.

19. A participant pointed out that, despite losses incurred by investors in infrastructure projects, large companies continued to invest heavily in selected developing countries, which suggested that globalization continued to present considerable opportunities for the private sector. While acknowledging the fact that

some public authorities had reneged on their contractual obligations, he argued that some foreign companies had also failed to respect their obligations and to deliver, thus making Governments wary of allowing certain projects. A representative of the business sector accepted the point that investors sometimes failed to fulfil their responsibility and suggested that a combination of due diligence by investors and Governments and a fair and enforceable dispute resolution mechanism would help.

Conclusions

20. **A number of important points were raised during the presentations and discussions between representatives of the business sector and other stakeholders present. They include the following assertions:**

(a) **There is a need to enhance private-public sector collaboration to improve information for investors in developing countries, particularly in the following areas:**

- **Enhancing the use of technology and the Internet to strengthen public-private dialogue and disseminate information. For example, Internet based country-investor networks would facilitate direct and frequent communication between Governments and investors. In addition, efforts should be made to improve the quality and synergy of existing open web-based information portals as cost-effective vehicles to disseminate information through strengthening linkages with key information providers and using technology to its maximum potential.**

- **Investment in capacity-building in information infrastructure in developing countries, including strengthening the provision of sector-based information and training that would provide guidance on the gathering, analysis and dissemination of high-quality information. This would also involve the promotion of best practices, including documentation and provision of easy access to investment-related legislation and policies and making investment-related local laws and policies publicly available and measurable.**

(b) **It is important to ensure that both governmental and non-governmental providers of information coexist, thereby enabling investors to have a full and balanced view of developments in a developing country.**

(c) **IMF may be constrained in its freedom and independence to highlight fully the macroeconomic risks faced by countries. An alternative international organization, not involved in lending to countries, should be handed the key surveillance responsibility for assessing and highlighting macroeconomic risks.**

(d) **There are a number of promising approaches to risk sharing (including project pooling, global development funds, use of liquidity facilities to overcome temporary shocks to project finances such as a massive devaluation, local currency guarantees, concessionary finance to subsidize targeted users, international arbitration to ensure government contracts and concession agreements, etc.). In order for these techniques to find wider application, there needs to be increased dialogue between the public and private sectors. The Experts Group on Developing Country Infrastructure Finance was initiated at the Monterrey International Conference on Financing**

for Development in order to facilitate this dialogue. Interested experts from the private and public sectors should join this group and contribute to the development of appropriate risk-sharing mechanisms.

(e) It is important to create project development capacities within Governments in developing countries that would provide for credible risk identification, risk mitigation and allocation structures for projects and would address the information requirements to minimize uncertainties in the perception of the private sector and the lending institutions. This can be achieved through establishing a permanent professional body in individual developing countries that would provide continuous and competent guidance to public-private partnerships and to stakeholders in the public and private sectors. Multilateral organizations like the United Nations, and other donors, can assist in creating institutional arrangements and a regulatory environment that would facilitate the work of this body (for example, through establishing and updating guidelines for public-private partnerships, assisting in the creation of a legislative framework to guide political and bureaucratic decision-making related to public-private partnerships and imparting necessary training and technical skills).

(f) Sustainable cost recovery is achievable in water services in most large cities over the long term if there is a well-designed and socially equitable policy of progressive tariff adjustments accompanied by risk mitigation instruments. There should be a transition towards a greater degree of economic self-sustainability, but at the same time vulnerable sections of society should be protected by Governments through targeted subsidies. A tariff risk mitigation instrument should be considered whereby the public authority would guarantee the water operator against unilateral decisions on tariffs, but would have access to an appropriate counter-guarantee backed by a multilateral agency. The cost of this counter-guarantee should be minimized through donors' support.

(g) The large amounts of foreign reserves being accumulated by central banks in some developing countries could be used to provide incentives to attract foreign investment. However, given the resource constraints in the developing world, they should be used very selectively and only for those projects in strategic sectors that would have significant direct and spill-over effects on the host country economy.

(h) There needs to be greater consideration of how to tackle the difficulties experienced by developing countries regarding key infrastructure projects during times of economic crisis, when Governments are least able to provide risk insurance since their budgets have been severely hit by economic problems.